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No. 00-1393

IN THE

Supreme Court of the United States

CO-STEEL, INC.,

Petitioner,

v.

NEW JERSEY BOARD OF PUBLIC UTILITIES,

Respondent.

On Petition for a Writ of Certiorari to the
Supreme Court of the State of New Jersey

REPLY BRIEF OF PETITIONER

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A. Respondents' Contention That New Jersey Has An Unlimited Right To Modify Contracts Dealing With Matters Subject To Its Regulatory Jurisdiction Demonstrates That This Case Is Of Significant, National Importance And Has Been Resolved Below In A Manner Inconsistent With Previous Decisions Of This Court

Co-Steel has a constitutionally protected property interest in its 1995 contract with Public Service Electric & Gas Company ("PSE&G").[1] At the time the contract was executed by the parties and approved by the State of New Jersey, the contract was expected to reduce Co-Steel's electric costs by $60 million and provide, in a very real sense, the "daily subsistence"[2] required to keep Co-Steel in business and to keep its expenditures and jobs in the State of New Jersey.[3]

Co-Steel gave valuable consideration for the benefits it expected to receive under the contract. Co-Steel abandoned its plans to re-locate to another state and invested $37 million in capital improvements at its Raritan plant. And, Co-Steel agreed to forego for ten years whatever opportunity might be provided by future legislation to obtain electricity from a supplier other than PSE&G.[4]

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[1] Contract rights are a form of constitutionally protected property. *See United States Trust Co. of New York v. New Jersey*, 431 U.S. 1, 19 n.16, *reh'g denied* 431 U.S. 975 (1977).

[2] *Goldberg v. Kelly*, 397 U.S. 254, 255, 261-64 (1970).

[3] The BPU's brief incorrectly claims that Co-Steel also received certain tax benefits. BPU Brief at 11. As the BPU well knows, the tax adjustment addressed in the July 20, 1995 Memorandum of Understanding between PSE&G, Co-Steel and the New Jersey Department of the Treasury relates to New Jersey's Gross Receipts and Franchise Unit Tax, which is assessed on energy sales and paid by PSE&G, not Co-Steel. See App., at 441a–443a.

[4] Co-Steel is, therefore, the *only* electric consumer in the State of New Jersey that cannot avail itself of the right to access a competitive supplier that was statutorily established by N.J.S.A 48:3-50(b)(3). Respondents description of the Act as extending to "all customers" (BPU Brief at 5-6)

As both Respondents know full well, the rates of PSE&G's other electric customers did not increase as a result of the price reductions extended to Co-Steel since 1995. PSE&G itself absorbed the loss of revenue. Likewise, and contrary to the express statements in both Respondents' briefs,[5] the contract with Co-Steel could have been honored and none of the transition costs assessed to other electric customers would have increased if the Board had simply reduced PSE&G's total stranded costs by the value of its agreement with Co-Steel. By not doing this, the State of New Jersey has legislatively and administratively negated the economic value that Co-Steel expected to receive under the contract and returned to PSE&G in the form of $60 million[6] in "stranded costs"[7] the $60 million in revenues that PSE&G had agreed to forego in the form of rates.[8]

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will not be true until November 17, 2005, the date the Co-Steel-PSE&G contract expires.

[5] *See* PSE&G Brief at 19, BPU Brief at 17.

[6] BPU's claim that this figure is unsubstantiated (BPU Brief at 20, n. 5) is unfair. The Board knows full well that, because the stranded cost assessment was fixed after the hearings ended, the figure is necessarily a mathematical calculation derived from the record evidence, which was based upon PSE&G's filing before its stranded costs were determined. The record evidence thus supports the even higher calculation that Co-Steel's annual stranded cost surcharge would be $7.5 million, or $112.5 million during the fifteen-year term during which it will be collected. App., at 380a.

[7] PG&E's statement (PSE&G Brief at 16 n.26) that Co-Steel could avoid future stranded costs by self-generation is *entirely* without any record support. As PSE&G must surely know, self-generation to support an electric arc furnace is currently economically and technically infeasible. The additional suggestion that Co-Steel could simply leave the state would defeat the purpose of the contract.

[8] Throughout their briefs Respondents have frequently stated that Co-Steel seeks to pay *none* of the costs associated with the transition to competition. *See, e.g.*, BPU Brief at 25. Respondents know that this is untrue. Co-Steel has never contested the assessment of charges associated with approved social programs, conservation and environmental programs,

This is, of course, an important issue for Co-Steel. Respondents' briefs also demonstrate, however, precisely why this issue is also of significant national importance. For those briefs now make clear that the reason the State, the BPU, and the courts have given short shrift to Co-Steel's claim that the Electric Deregulation and Energy Competition Act[9] ("EDECA") violates the Contracts Clause, is that they do not believe that Co-Steel has any legitimate claim of entitlement whatsoever with regard to the contract. Those briefs also make clear that it really would not have mattered to the BPU or the courts whether Co-Steel had been sufficiently clairvoyant as to anticipate a charge that had not yet been conceived, let alone proposed to be implemented when the contract was under negotiation.[10] It would not have mattered

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as well as nuclear decommissioning and consumer education costs, through the nonbypassable societal benefits charge ("SBC"). Co-Steel opposes only the imposition of the Market Transition Charge ("MTC"), which attempts to recover stranded costs in investment which, because of Co-Steel's non-firm, interruptible service, were never made by PSE&G on behalf of Co-Steel and which PSE&G agreed to forego in the 1995 contract. *See* Testimony of Scott Norwood, App., at 390a-391a.

[9] N.J.S.A. 48:3-49 *et seq.*

[10] One of the consistent themes of Respondents throughout these proceedings has been that Co-Steel was remiss in failing to include a prohibition on the imposition of stranded cost charges in 1995. *See, e.g.*, PSE&G Brief at 15. But that expectation is unreasonable.

Respondents themselves can cite to nothing prior to the BPU's Final Report of April 30, 1997 that could fairly have put anyone on notice that restructuring was likely to involve the kind of stranded cost surcharges that PSE&G finally requested in its petition of July 15, 1997. Moreover, even the April 30, 1997, Final Report acknowledged that legislation was needed "to provide the necessary legal authority to implement its recommendations." App., 24a, cited at BPU Brief at 4.

This is entirely consistent with the testimony from Co-Steel's negotiator, Mr. Dimiceli, that at the time of the contract negotiations he was only "very generally aware that electric industry deregulation was somewhere on the horizon and that it might occur to one degree or another in the succeeding few years" (App., at 407a.) and that "the subject of stranded costs never was raised by PSE&G during the negotiations."

if the contract did not have the provision in Paragraph 7 allowing PSE&G to pass through new taxes or other assessments incurred by PSE&G. It would not even have mattered if the contract did not have the provision in Paragraph 9, acknowledging that the contract was subject to the future exercise of the State's regulatory authority. Respondents' essential argument that they could "harmonize"[11] away every penny of Co-Steel's anticipated economic benefit is ultimately based not on the need to interpret or reconcile any of the contract provisions. Respondents' argument is based on their view that the State's regulatory authority is not only inalienable but that it is also *unlimited!* That argument is unprecedented, and it threatens the integrity of decisions such as *Atlantic Coast Line R.R. Co. v. Goldsboro*,[12] which holds that this power must be reasonably and fairly exercised.[13] This unprecedented assertion of the power to completely negate the value of a contract absent any evidence of emergency takes on added significance when exercised in connection with the transfer of billions of dollars of assets as part of a nationwide regulatory reform movement that is also making the use of electric supply contracts the rule, rather than the exception.

(App., at 407a.) It is also entirely consistent with the testimony of PSE&G's negotiator that he had never even heard of the term "stranded cost" at the time of the negotiations. BPU Tr. 288:22-289:21.

[11] PSE&G Brief at 17.

[12] 232 U.S. 548 (1918).

[13] *See Energy Reserves Group, Inc. v. Kansas Power & Light Co.*, 459 U.S. 400, 411-12 (1983) (where a state regulation constitutes a substantial impairment of a contractual relationship the state must have a legitimate public purpose and the adjustment of the contracting parties' rights and responsibilities must be based upon reasonable conditions and of a character appropriate to the public purpose justifying the interference); *see also United States Trust Co. of New York*, 431 U.S. at 22.

B. The Dissenting Opinion of Justice Stein Correctly Identifies The Procedural Irregularities Below And Demonstrates That The Parties Representing Consumer Interests Were Denied Due Process of Law

Of all that has been written in the proceedings below, the Dissenting Opinion of Justice Stein,[14] which was not available to Co-Steel at the time the Petition was filed, gives the most accurate and complete rendition and treatment of the procedural irregularities that the Petition attempted to summarize.[15] Justice Stein stated that he

> fully agree[d] with petitioners' contentions that the lack of an adequate evidentiary hearing concerning the value attributable to PSE&G's stranded assets denied due process to petitioners, and that the evidence in the record was insufficient to support the BPU's generation asset valuation and stranded cost determination.[16]
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> * * *
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> Not only was the restructuring hearing mandated by EDECA never held with respect to the transfer of generation-related assets to GENCO, but also the stranded costs hearing before the ALJ was based on the ultimately incorrect premise that PSE&G would retain its generation assets for seven years. Rather than reopen the hearing as requested, and achieve compliance with the letter and spirit of EDECA, the BPU based its stranded cost calculation on stale evidence before the ALJ focused on income projections but omitting any proof of market-based valuations, and relied heavily on the ICF report that never had been subjected to cross-examination or

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[14] Supp. App., at 31sa-41sa.

[15] Petition at 10-13.

[16] Supp. App., at 31sa.

> rebuttal. In addition, the BPU utterly failed to provide in its Final Order any explanation for selecting ICF's mid-range figure as the basis for valuing PSE&G's stranded costs. Most disturbing is the fact that the BPU's flawed stranded cost valuation, because of its substantial economic impact on customers over the next fifteen years, in all likelihood was the most significant of all of the factual findings in the Final Report.[17]

Respondents discuss such conclusions primarily through the same obfuscations upon which they have relied to minimize the irregularities below. Thus, for example, Respondent PSE&G contends that the post-hearing modification of its plan of operation was of no consequence because it had been a proposal made by "several customers and supplier parties" to which the Company "acquiesced" in the post-hearing settlement negotiations.[18]

An even more elaborate ruse is played out in connection with the BPU's use of the post-hearing report of the independent auditors. As the record demonstrates, there were two reports prepared by the auditors. The first was the valuation report submitted during the evidentiary hearings and on which the auditors were cross-examined.[19] After the Initial Decision of the Administrative Law Judge did not quantify either the value of PSE&G's assets or its stranded costs,[20] the BPU auditors were requested by the Board to submit a second report "to quantify the Company's stranded costs based on the

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[17] Supp. App., at 40sa–41sa.

[18] PSE&G Brief at 10.

[19] PSE&G Brief at 6.

[20] App., at 26a. PSE&G's brief disputes Justice Stein's conclusion regarding the reason why the ALJ failed to quantify the value of these assets, but not the basic fact that the assets were not valued at the time of the Initial Decision. PSE&G Brief at 6 n.10.

ALJ's recommendations."[21] This report "was distributed to all parties in November 1998" in a letter from BPU staff.[22] Significantly, the parties were never informed that the report might itself be considered as evidence by the Board and no party submitted comments upon it.[23] Nonetheless, it was this second report upon which the BPU relied in determining the value of PSE&G's assets and its stranded costs. Given the objections that have since arisen to the BPU's use of that report, the fact that *no* party responded in any way to staff's letter renders it far more likely that the parties saw the report as having no evidentiary significance, and had no notice of the fact that BPU intended to use it as evidence, than that they knowingly waived their right to comment upon it.

In trying to dismiss Justice Stein's conclusions about the two reports, PSE&G weaves a carefully crafted story. At page 6, PSE&G refers to the auditors who prepared the first report "to which all parties had access, and [who] were subject to cross-examination on *that* report . . . ."[24] Significantly, when referring to the *second* report later in that same paragraph, PSE&G states only that "it was distributed to all parties in November 1998."[25] The attempt to fully blur the distinction between the report on which the auditors were cross-examined and the subsequent report on which they were not is brought to fruition at page 10. There, resorting to a technique used throughout its brief, the Company skewed the "incorrect suggest[ion]" that the auditors were from different companies and demonstrates, to the contrary, that "those entities were one and the same."[26] This helpful clarification to

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[21] PSE&G Brief at 6.

[22] BPU Brief at 5.

[23] BPU Brief at 5.

[24] PSE&G Brief at 6 (emphasis added).

[25] PSE&G Brief at 6.

[26] PSE&G Brief at 10 n.18.

a "suggestion" that none of the parties ever made is tied to text stating that auditors "that had prepared the independent audit report" had been subjected to three separate days of cross-examination. The attempt to make it appear that the auditors were subject to cross-examination on the second report is patent, but untrue. Although carefully crafted to obscure reality, PSE&G's brief actually plainly reveals and confirms that although the parties had opportunity to confront and cross-examine the BPU auditors in connection with the report submitted *during* the evidentiary hearing, they had no similar opportunity to confront and cross-examine the authors of the report prepared *after* the hearing. The BPU relied upon that post-hearing report to resolve disputed issues of adjudicative fact and, in so doing, violated fundamental precepts of due process.

C. Respondents Have Failed To Demonstrate That There Is Any Rational Relationship Between The Objectives Of The Act And The Board's Decision To Deny Co-Steel The Statutorily Mandated Rate Reduction On Its "Block 2" Purchases

According to the BPU, "EDECA was enacted to bring the benefits of competition and lower electric rates to *all* of the State's customers."[27] The "pertinent"[28] provision of EDECA states quite clearly and succinctly that, "[d]uring a term to be fixed by the board, each public utility shall reduce its aggregate level of rates for each customer class . . . ."[29] The Board's only discretion relates to the length of the term during which the rate reduction shall apply. With respect to Co-Steel, the Board concluded that the legislature "intended to reduce the rates [only] of customers receiving service under tariffs providing for fixed rates."[30] The BPU concedes,

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[27] BPU Brief at 25.

[28] BPU Brief at 22.

[29] N.J.S.A. 48:3-52(d)(1).

[30] PSE&G Brief at 20.

however, that Co-Steel is served "under the EHEP Tariff,"[31] and the statute clearly makes no distinction between the EHEP Tariff and any other tariff. The exclusion of Co-Steel from the rate reduction mandated by the Act is, therefore, completely inconsistent with the specific language and intent of the Act to lower electric rates to "all customers," which, during the term set by the board, was to be accomplished by a reduction in the aggregate level of rates for each customer class. The BPU's unauthorized exclusion of Co-Steel has, thus, absolutely no rational relationship – indeed, is entirely contrary – to the purpose and express language of the Act and arbitrarily denies Co-Steel the equal protection of the law.

D. The Issues Set Forth In The Petition Were Timely Raised Below

Co-Steel raised its claim that PSE&G's proposal to impose stranded cost charges violated and constituted an impairment of the 1995 contract from the very outset of these proceedings.[32] In light of its limited resources and in the interest of administrative efficiency, Co-Steel relied, as it was entitled to, upon the New Jersey Ratepayer Advocate, as representative of all of PSE&G's consumers,[33] to litigate those issues that Co-Steel had in common with all other consumers.[34] Initially, this included the existence and amount of PSE&G's stranded cost charges,[35] but expanded, as the proceedings progressed, to include a due process challenge to the procedures by which the existence and amount of those

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[31] BPU Brief at 10 n.4.

[32] Petition at 3; App., at 374a-446a.

[33] Petition at 3; N.J.S.A. 13:1D-1, at 29.

[34] It is completely inaccurate to state (e.g., BPU Brief at 7) or simply imply as they do throughout their briefs (*e.g.*,. BPU Brief at 26 and 27) that Co-Steel took "no position" on issues in which they held common positions with and were adequately represented by the Ratepayer Advocate.

[35] Petition at 3.

stranded cost charges had been determined.[36] Since these issues have been litigated below, Co-Steel is entitled to raise them here even if they are not part of the group represented by the Ratepayer Advocate.[37]

In addition, Co-Steel timely raised additional, independent due process and equal protection issues when the BPU excluded Co-Steel's "Block 2" purchases from the Act's mandate that statutory rate reductions should apply to "each customer class."[38] Respondents are wrong, therefore, to state or imply that Co-Steel raised these issues "belatedly."[39]

Respectfully submitted,

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[36] Petition at 13-14; App., at 42a. Indeed, Co-Steel would have been content to allow those issues the Ratepayer Advocate to litigate those issues here. Co-Steel included those issues in its own Petition only when it learned that the Ratepayer Advocate had a different view of the date on which a petition was due, given the entry of an order, but not an opinion, below.

[37] Petition at 14 n.42, and cases cited therein.

[38] N.J.S.A. 48:3-52(4)(d); Petition at 6-7. The BPU's assertion (BPU Brief at 2 n.2), that this issue was not among those certified by the court below is incorrect. *See* App., at 5a.

[39] BPU Brief at 27.